Executive Summary

Background

In Karnataka, fiscal reforms and consolidation were brought to the forefront with the State Government formulating the first Medium Term Fiscal Plan (MTFP) for the period 2000-05, based on broad parameters of fiscal correction laid down by the Eleventh Finance Commission (EFC). MTFP became a rolling annual document and the fiscal targets and policies set out in MTFP were dovetailed to the annual budgetary exercise. Karnataka was the first State to enact (September 2002) the Karnataka Fiscal Responsibility Act (KFRA), providing statutory backing to MTFP. The Act aims at ensuring fiscal stability and sustainability, enhancing the scope for improving social and physical infrastructure and human development by achieving revenue surplus, reducing fiscal deficit, removing impediments for effective conduct of fiscal policy and prudent debt management through limits on borrowings, debt and deficits and greater transparency in fiscal operations by the use of medium-term fiscal framework.

The Report

Based on the audited accounts of the Government of Karnataka for the year ended 31 March 2018, the Report provides an analytical review of the annual accounts of the State Government. The financial performance of the State has been assessed based on the KFRA, budget documents, Fourteenth Finance Commission Report (XIV FC) and other financial data obtained from various Government departments and organisations. The Report is structured in three chapters.

Chapter I is based on the audit of Finance Accounts and makes an assessment of Government of Karnataka's fiscal position as on 31 March 2018. It provides an insight into trends in committed expenditure and borrowing pattern and certain accounting adjustments that have a bearing on the fiscal parameters.

Chapter II is based on the audit of Appropriation Accounts and gives a description of appropriations and the manner in which the allocated resources were managed by the service delivery departments. Issues of budgeting affecting transparency of transactions are also brought out in this Chapter.

Chapter III is an inventory of Karnataka Government's compliance with various reporting requirements and financial rules.

The Report also includes appendices of additional data collected from several sources in support of these findings. A glossary of selected terms is given at the end of the Report.

Audit findings and recommendations

Fiscal position

The State recorded Revenue Surplus during 2013-14 to 2017-18 and maintained the fiscal deficit relative to Gross State Domestic Product (GSDP) below the limit laid down under KFRA, as amended from time to time. During 2017-18, the State had a Revenue Surplus of ₹4,518 crore, an increase of ₹3,225 crore over the previous year. There was an increase in revenue expenditure of eight *per cent* over the previous year, while the revenue receipts increased by 10 *per cent* during the year.

Fiscal deficit during 2017-18 was ₹31,101 crore, increase of ₹2,437 crore (nine *per cent*) from ₹28,664 crore in 2016-17. Primary deficit was ₹16,128 crore, an increase of ₹314 crore over the previous year. Incremental non-debt receipts of ₹13,800 crore was less than the incremental primary expenditure of ₹14,114 crore.

State's own resources

The ratio of the State's tax revenue to GSDP was between 6.65 and 7.69 *per cent* during 2013-14 to 2017-18. It also included book adjustment of ₹139.46 crore, which increased the revenue receipts artificially during the year on account of Guarantee Commission (₹13.80 crore) from Karnataka State Khadi & Village Industries Board, Karnataka Slum Development Board, Rajiv Gandhi Rural Housing Corporation Limited, Karnataka Road Development Corporation Limited and adjustment of motor vehicle tax dues of transport corporations as subsidy (₹125.66 crore).

Ratio of non-tax revenue to revenue receipts reduced from 4.50 *per cent* in 2013-14 to 4.41 *per cent* during 2017-18. Its ratio to GSDP (₹13,10,879 crore) was insignificant (0.49 *per cent* in 2017-18), implying the need for mobilising non-tax revenue in the coming years by revising user charges, as recommended by Expenditure Reforms Commission. During 2017-18, user fees pertaining to Tiger Conservation Foundation (₹46.75 crore) and contribution to the District Mineral Foundation fund which is percentage of royalty (₹909.96 crore as on 31.03.2018) were not remitted to Consolidated Fund of the State. Non-remittance of user charges escapes the scrutiny by the Legislature. Therefore, a system for remittance/release of such money needs to be put in place for tracking the revenues/expenditure and assurance to indicate that the money generated from the sector is ploughed back into the same sector for development.

Optimisation of XIV Finance Commission Grants

During 2017-18, there was short release of ₹24.24 crore under Basic Grants to PRIs. Grants under Disaster relief continued at 75:25 ratio as per the recommendations of the XIII Finance Commission, even though the GST has been implemented from 2017-18 onwards. The Performance Grants to Panchayat Raj Institutions (PRIs) and Urban Local Bodies (ULBs) were not released till the end of March 2018.

Fourth State Finance Commission

The period of applicability of the Third State Finance Commission recommendations is extended until 2017-18, as the recommendations of the Fourth State Finance Commission are applicable from 2018-19 to 2022-23. The share of local bodies as percentage of Non-Loan Net Own Revenue Receipts (NLNORR) would be increased from 42 *per cent* to 48 *per cent* and for ULBs it would be increased from 10 to 12 *per cent* in a phased manner.

Revenue Expenditure

Expenditure under social and economic sector registered growth of eight and six *per cent* respectively over the previous year, while the growth in general services was ten *per cent*. Seventy-eight *per cent* of revenue expenditure consisted of committed expenditure on salaries, devolutions to local bodies, interest payments, pensions, subsidies, administrative expenses, grants-in-aid and financial assistance. The committed expenditure consumed 75 *per cent* of revenue receipts. Expenditure on subsidies decreased from ₹14,387 crore in 2016-17 to ₹14,148 crore during 2017-18 and subsidy in the form of financial assistance, incentives etc., also decreased from ₹3,714 crore in 2016-17 to ₹3,318 crore during 2017-18. The XII Finance Commission recommended that the expenditure forming subsidy in the form of financial assistance, incentives etc., should be brought out in Finance Accounts for transparency. However, this is not being done.

Quality of Expenditure

The share of capital expenditure to total expenditure during the year 2017-18 was 20 *per cent* (₹35,760 crore) as against 19 *per cent* (₹30,084 crore) in the previous year. Funds aggregating to ₹967 crore were blocked in incomplete projects at the end of 2017-18. The return from investment of ₹65,146 crore as on 31 March 2018 in Companies/Corporations was negligible (₹78.83 crore). The investment included ₹38,912 crore (60 *per cent*) in Companies/ Corporations under loss.

Funds and other Liabilities

The interest accrued on the investment out of Consolidated Sinking Fund of ₹2,070 crore amounting to ₹484.36 crore did not form the part of the assets of the State Government as the transaction did not pass through the Government books. Green Tax Cess of ₹62.25 crore along with relevant expenditure was not transferred to Green Tax Fund. Transfer of ₹2,768 crore from Consolidated Fund to Infrastructure Initiative Fund (IIF), Bangalore Metro Rail Corporation Limited (BMRCL) fund and Chief Minister Rural Road Development (CMRRD) fund and non-transfer of expenditure (₹299.09 crore) to Forest Development Fund in Public Account artificially inflated revenue expenditure. The Guarantee Redemption Fund was not revived.

Debt Sustainability

Open Market Loans had a major share (51 *per cent*) in the total fiscal liabilities of the State. The percentage of debt to GSDP in 2017-18 was 18.78 *per cent*, which was within the limit of 25 *per cent* as mandated under KFRA 2002. The net debt available to the State during the year 2017-18 (₹5,005 crore) decreased by 63 *per cent* when compared to the previous year.

Financial Management and Budgetary Control

Against total provision of ₹2,09,479 crore during 2017-18, an expenditure of ₹1,92,320 crore was incurred, resulting in unspent provision of ₹17,159 crore (eight *per cent*). Release of money from the Consolidated Fund to the implementing agencies should be based on requirement of funds rather than to avoid lapse of budget grants. It was revealed that expenditure stood overstated to an extent of ₹903.02 crore mainly due to release of funds to ZP/TP remaining unutilized. Excess expenditure of ₹199.44 crore (₹12.00 crore under Demand No.3, ₹80.98 crore under Demand No.8, ₹12.95 crore under Demand No.24, and ₹93.51 crore under Demand No.29) over provision for the year 2017-18 are required to be regularised under Article 205 of the Constitution.

Supplementary provision of ₹171.53 crore in 13 cases was unnecessary, re-appropriation of funds in 44 cases was made injudiciously, resulting in either un-utilised provision of funds or excess over provision. In 17 grants, savings in excess of rupees five crore amounting to ₹2,246.23 crore was surrendered in the last two working days of the financial year.

In six cases, involving six grants, excess expenditure amounting to ₹436.56 crore, which should be treated as 'New Service/New Instrument of Service' was incurred without the approval of the Legislature.

An amount of ₹3,476.63 crore was misclassified under the capital/revenue section affecting the fiscal indicators. Misclassification under the object head 059 – Other Expenses, an omnibus head to record minimum expenditure, amounted to ₹1,597.83 crore.

Supplementary budget was not assessed for being fiscally neutral as it failed to exhibit the statement indicating the corresponding curtailment of expenditure/ augmentation of revenue to fully offset the impact of the supplementary estimate in relation to the budget targets of the current year' as required under the provisions of KFRA.

Payment of excess family pension continued, as an amount of ₹1.11 crore in 93 cases was drawn in excess, and there was continued excess payment of family pension amounting to ₹1.15 crore in 66 cases.

Budgetary control should be strengthened in all departments to avoid cases of provision remaining unutilised as large un-utilised provisions were observed across several grants. The budgetary exercise should be more realistic as there were cases of persistent non-utilisation of funds, excessive provision of funds and large provisions remaining un-utilised.

The budget/expenditure suffered from inadequate disclosure on account of operation of incorrect budget lines for release and accounting of Urban Local Bodies (ULB) grants. Distinct heads should be opened for accommodation of budget/expenditure of the ULB sector to ensure that the grants released to ULBs should be distinct from that of the State Sector. The budget document brought out for devolutions to ULBs should be reviewed for classification of expenditure, avoiding merger with the State budget.

Financial Reporting

Non-payment Detailed Contingent (NDC) bills, against Abstract Contingent (AC) bills, were pending over a long period and large sums of money were retained in Personal Deposit (PD) accounts against the principle of Legislative financial control. Non reconciliation of expenditure was to the extent of 20 *per cent* of total expenditure. There were adverse balances under certain Debt, Deposit and Remittance (DDR) heads, which required remedial action for their clearance.

Suspense accounts needs speedy clearance by taking up the matter with the concerned authorities as they have a bearing on the cash balance of the Government. The departments of the Government should bring the revenues realized on behalf of Government to Consolidated Fund within the time stipulated in the Karnataka Financial Code. The transactions of Government Account should be transparent to exhibit the correct head of account as there were instances of misclassification of expenditure relating to revenue under capital/loan head of account.